



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JAMES E. WHITE)

For Appellants: Kerry G. Judd
Certified Public Accountant

For Respondent: Carl G. Knopke
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of James E. White against a proposed assessment of additional personal income tax in the amount of \$3,860.90 for the year 1971.

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The sole issue for determination is whether stock received by appellant for services rendered constitutes taxable income.

Prior to and during the appeal year appellant was the president and manager of Cred-X Corporation. The corporation was engaged in the development and marketing of a credit card machine that could automatically determine the validity and authenticity of a credit card. Appellant was to receive a salary and management fee for his services. Because of cash flow problems, however, appellant did not actually receive the compensation due him. Instead, the amount was simply accrued on the corporation's books as an account payable.

Ultimately, this problem was addressed at a special meeting of the corporation's board of directors held on August 23, 1971. The minutes of the meeting state, in pertinent part:

The board next considered the question of issuing to Mr. White shares of stock of the corporation in satisfaction of a portion of \$125,000 accrued indebtedness of the corporation to Mr. White for services rendered to Cred-X Corp. and its predecessor over the past two and one-half years. This matter had been raised and discussed at the previous meeting of the board. After further discussion, and upon motion: first duly made and seconded, the following resolution was adopted.

Resolved: That this corporation issue to James E. White 250,000 shares of the corporate one cent (1¢) par value capital stock in consideration of Mr. White's cancellation of \$50,000 of indebtedness of the corporation to him (which amount represents one year's salary of the two and 1/2 years' salary owing to him.)

The stock was actually received by appellant during 1971.

At a meeting of the corporation's directors held on December 6, 1972, it was proposed and approved that appellant return the 250,000 shares issued to him and that the corporation, once again, reflect the

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\$50,000 back salary in its books of account as a debt owed to appellant. The actual return of the shares was noted in the minutes of a meeting of the directors held on March 3, 1973. Appellant has stated that at the time the corporation requested the return of the shares, the value of the shares was \$2.50 per share. The corporation's secretary has also stated that at some unspecified time after the stock's issuance to appellant, but prior to its return, the shares were selling for \$2.50 per share.

Appellant did not include in his 1971 gross income any amount with respect to the receipt of the 250,000 shares of stock from Cred-X. Respondent determined that appellant had received income in an amount equal to the fair market value of the stock received, which was determined to be the same as the \$50,000 obligation discharged, or 20-cents a share. Accordingly, respondent increased appellant's 1971 income by \$50,000. It is from this determination that appellant appeals.

The Revenue and Taxation Code provides that property received as compensation for services rendered shall be included in the recipient's gross income to the extent the fair market value of the property received exceeds any amount paid for the property. (Rev. & Tax. Code, § 17122.7.) If a corporation transfers its own stock to an employee as compensation for services rendered, the fair market value of the stock at the time of transfer shall be included in the employee's gross income. (Commissioner v. Fender Sales, Inc., 338 F.2d 924 (9th Cir. 1964) cert. den. 382 U.S. 813 [15 L.Ed.2d 61] (1965); Hughes-v. United States, 323 F.Supp. 1297 (D.C. Wyo. 1970); Rev. Rul. 67-402, 1967-2 Cum. Bull. 135.) Stock so issued is presumptively equal in value to the liquidated obligation discharged.

In applying this presumption, respondent has determined that the fair market value of the 250,000 shares of stock received by appellant was equal to the \$50,000 obligation discharged, or 20-cents a share. Appellant contends that the fair market value of the stock was zero.

Appellant's position is based on an analysis of the corporation's balance sheet as of June 30, 1972. Primarily, appellant argues that in computing the value of the stock the corporate assets should be reduced by the capitalized value of the research and development

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costs and by the notes receivable from corporate officers. If the assets, as revalued, were compared with the corporation's real liabilities, appellant continues, 'it would appear that the corporation was on the verge of insolvency. Therefore, appellant concludes that the stock was without value when received. We disagree.

As indicated above, the stock is presumed to be equal in value to the obligation discharged, which was \$50,000. As the president of the corporation, appellant was in a very good position to ascertain the value of the stock. In the absence of some compelling reason which does not appear in the record, it is highly unlikely that appellant would have accepted worthless stock in satisfaction of a \$50,000 debt. Furthermore, appellant stated that the value of the shares was \$2.50 per share, or \$625,000 in total, when the corporation requested their return in 1972. Finally, the corporate secretary stated that the shares were selling for \$2.50 per share between the time they were issued to appellant and the time they were returned to the corporation, a period of slightly more than one year. In view of these circumstances, it is difficult to believe that the shares were valueless when received by appellant during 1971. Accordingly, we conclude that respondent's determination that the stock had a fair market value of 20-cents per share when received by appellant in 1971 was correct.

Next, appellant argues that the fair market value of the stock should not be included in his 1971 gross income because he returned the stock to the corporation in a subsequent year. However, it is well settled that if a taxpayer receives property under an unrestricted claim of right, he has received income which is **includible** in gross income for the year of receipt even though he is required to return the property or its equivalent in a later year. (Healy v. Commissioner, 345 U.S. 278 [97 L.Ed. 1007] (1953); United States v. Lewis, 340 U.S. 590 [95 L.Ed. 5601, reh'g den. 341 U.S. 923 [95 L.Ed. 13561 (1951); North American Oil Consolidated v. Burnet, 286 U.S. 417 [76 L.Ed. 1197] (1932).) If the taxpayer is required to return the income or its equivalent in a subsequent year, he is entitled to a deduction in the year of repayment. (See Healy v. Commissioner, supra; North American Oil Consolidated v. Burnet, supra.) In view of these well settled principles, appellant's argument must be rejected.

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For the reasons discussed above, respondent's action in the matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of James E. White against a proposed assessment of additional personal income tax in the amount of **\$3,860.90** for the year 1971, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of May 1981, by the State Board of Equalization, with all Board members present.

Ernest J. Dronenburg, Jr., Chairman

George R. Reilly, Member

William M. Bennett, Member

Richard Nevins, Member

Kenneth Cory - -, Member